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MEMORANDUM

TO: Committee on Legal Services

FROM: Esther van Mourik, Office of Legislative Legal Services

DATE: December 1, 2020

SUBJECT: Rule 39-22-103(5.3), issued by the Taxation Division, Department of Revenue, concerning the Internal Revenue Code definition, 1 CCR 201-2 (LLS Docket No. 200503; SOS No. 2020-00401).[1]

Summary of Problem Identified and Recommendation

Section 39-22-103 (5.3), C.R.S., defines the "Internal Revenue Code" as "the provisions of the federal "Internal Revenue Code of 1986", **as amended**, . . .". But Rule 39-22-103(5.3) changes this definition in a way that conflicts with the statute. **Because Rule 39-22-103(5.3) conflicts with the statute, we recommend that Rule 39-22-103(5.3) of the rules of the Department of Revenue concerning the Internal Revenue Code definition not be extended.**

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[1] Under § 24-4-103, C.R.S., the Office of Legislative Legal Services reviews rules to determine whether they are within the promulgating agency's rule-making authority. Under § 24-4-103 (8)(c)(I), C.R.S., the rules discussed in this memorandum will expire on May 15, 2021, unless the General Assembly acts by bill to postpone such expiration.

Analysis

1. Rule 39-22-103(5.3) conflicts with section 39-22-103 (5.3), C.R.S., and should therefore not be extended.

Article III of the Colorado Constitution, otherwise known as the separation of powers doctrine, provides that the legislative function is to make the law, the executive function is to enforce and administer the law, and the judicial function is to interpret the law.[2] It is well established that the General Assembly is the branch of government tasked with setting tax policy.

The Executive Director of the Department of Revenue (DOR) has the following rulemaking authority:

> **39-21-112. Duties and powers of executive director.** (1) It is the duty of the executive director to administer the provisions of this article, and he or she has the power to adopt, amend, or rescind such rules **not inconsistent with** the provisions of this article, articles 22 to 29 of this title, and article 3 of title 42, C.R.S., . . . (**Emphasis added**).

This is very broad rulemaking authority. While the General Assembly maintains the legislative power to establish tax policy, the General Assembly has granted extensive administrative power to the Executive Director of the DOR. Only a rule that is clearly inconsistent with one or more statutes may be deemed to have been promulgated outside of the Executive Director's rulemaking authority.

Section 39-22-103 (5.3), C.R.S., defines the "Internal Revenue Code" as follows:

> **39-22-103. Definitions - construction of terms.** As used in this article, unless the context otherwise requires:
>
> (5.3) "Internal revenue code" means the provisions of the federal "Internal Revenue Code of 1986", **as amended**, and other provisions of the laws of the United States relating to federal income taxes, as the same may become effective at any time or from time to time, for the taxable year. **(Emphasis added.)**

While enacted 34 years ago, the "Internal Revenue Code of 1986" (IRC) is indeed the current version of the federal tax code. However, the IRC has been amended numerous times since enacted, most recently through the December 2017 "Tax Cuts and Jobs

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[2] *MacManus v. Love*, 179 Colo. 218, 499 P.2d 609 (1972).

Act," Pub.L. 115-97, and the March 2020 "Coronavirus Aid, Relief, and Economic Security Act", Pub.L. 116-136. The definition of the IRC set forth in section 39-22-103 (5.3), C.R.S., is important to the rule at issue here because the sections of the Colorado Revised Statutes that impose income tax on individuals, estates, trusts, partnerships, and corporations in Colorado[3] rely on this statutory definition of the IRC.

Across the nation, states conform to the IRC in a variety of ways.[4] Roughly twenty states have rolling conformity, meaning that changes to the federal law automatically apply to the state law. And eighteen states have static conformity, meaning that the state conformity statute adopts the federal law on a certain date. Either way, conforming to the IRC allows state tax administrators and taxpayers to rely on federal law, as well as federal judicial rulings and administrative interpretations that are generally more detailed and extensive than what any state taxing agency could produce.

Because section 39-22-103 (5.3), C.R.S., specifies "as amended," Colorado is a rolling conformity state in which any changes to the federal law, regardless of when those changes are enacted, automatically apply to the state law unless the General Assembly enacts legislation to make a different tax policy decision, including establishing when statutory rolling conformity to the IRC should or should not apply in a tax year.

Colorado's income tax is a percentage of federal taxable income as defined in the IRC.[5] Federal taxable income[6] is generally described as the amount of a person's gross income that the federal government deems subject to federal taxes and is most often less than gross income, having been reduced by federal deductions and exemptions. Because of Colorado's rolling conformity, federal tax policy changes can make significant impacts to the state budget by either increasing or decreasing state income tax revenue. Sometimes when Colorado is presented with a rolling conformity change that could reduce state revenues, legislation is enacted to ensure that the federal tax policy change is exempted from the usual rule of rolling conformity.

As stated, section 39-21-112 (1), C.R.S., clearly establishes that the Executive Director of the DOR is tasked with administering the tax code and promulgating rules as

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[3] *See* §§ 39-22-104, 39-22-301, and 39-21-304, C.R.S.

[4] Eight states do not have an individual income tax so there is no need for them to conform at all. Only four states calculate their own income tax without consideration of the IRC.

[5] *See* §§ 39-22-104, 39-22-301, and 39-21-304, C.R.S.

[6] 26 U.S.C. § 63.

necessary to do so. However, "to administer" means to apply the law, enforce the law, and establish procedures so that taxpayers can meet the tax code's requirements. "Administer" does not include rewriting the tax statutes by rule.

The rule redefines the "Internal Revenue Code" as follows:

> **Rule 39-22-103(5.3). Internal Revenue Code Definition - Prospective.**
>
> …"Internal revenue code" does not, for any taxable year, incorporate federal statutory changes that are enacted after the last day of that taxable year. As a result, federal statutory changes enacted after the end of a taxable year do not impact a taxpayer's Colorado tax liability for that taxable year. **Changes to federal statutes are incorporated into the term "internal revenue code" only to the extent they are in effect in the taxable year in which they were enacted and future taxable years**. (**Emphasis added.**)

Because the rule specifies that changes to federal statutes are incorporated in the definition of the IRC only to the extent that they are in effect for the taxable year in which they were enacted and for future taxable years, the DOR has limited Colorado's rolling conformity and has instead by rule imposed a limited form of static conformity.

The DOR even describes its rule as being different from statute, explaining in its statement of basis and purpose that "[t]he purpose of these rules is to clarify that the term 'internal revenue code' incorporates changes to federal statute only on a prospective basis." This limitation is not included in section 39-22-103 (5.3), C.R.S., which plainly and unambiguously states that the IRC includes "the provisions of the federal 'Internal Revenue Code of 1986', **as amended,**" (**emphasis added**) without any limitation as to what the substance of any amendment is or when any amendment was enacted. All amendments to the IRC are included in the definition of IRC set forth in section 39-22-103 (5.3), C.R.S. Therefore, by endeavoring to override the statute so that some federal amendments to the IRC are not included for certain taxable years, the rule conflicts with the statute.

2. Reliance on rule of statutory construction is misplaced.

The DOR relies on section 2-4-202, C.R.S., in its statement of basis and purpose to support the rule. The DOR presumably relies on this section to argue that since this canon of statutory construction declares that statutes are to be presumed to be prospective, their rule is acceptable. This reliance on section 2-4-202, C.R.S., is misplaced. Specifically, section 2-4-202, C.R.S. says:

> **2-4-202. Statutes presumed prospective.** A statute is presumed to be prospective in its operation.

However, the rules of statutory construction found in part 2 of article 4 of title 2, C.R.S., are only to be relied on when the plain reading of the statute indicates that there is an ambiguity. If the meaning of a statute is questioned in court, the first thing the judge does is read the statute. If the statutory language is clear on its face and there is no reasonable doubt as to its meaning, then the judge will simply apply the language of the statute to the case at hand. This is known as the plain meaning rule and it is codified in section 2-4-101, C.R.S.:

> **2-4-101. Common and technical usage.** Words and phrases shall be read in context and construed according to the rules of grammar and common usage. Words and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly.

Only when a statute is ambiguous will a judge look at one of the rules of statutory construction such as section 2-4-202, C.R.S.

Section 39-22-103 (5.3), C.R.S., is not ambiguous. It has been in place and has been operating without issue since it was enacted in 1992. In that 28-year period, the definition has not been amended by the General Assembly, nor has the DOR adopted a rule seeking to "clarify" the statute until this year.

Recommendation

We therefore recommend that Rule 39-22-103(5.3), issued by the Taxation Division, Department of Revenue, concerning the Internal Revenue Code definition, 1 CCR 201-2, not be extended because Rule 39-22-103(5.3) conflicts with the statute.